

CALIFORNIA DEPARTMENT OF JUSTICE

TITLE 11. LAW

DIVISION 1. ATTORNEY GENERAL

CHAPTER 16. Master Settlement Agreement, Tobacco

INITIAL STATEMENT OF REASONS

I. Problem Statement

In 1998, 46 states entered into a Tobacco Master Settlement Agreement (“MSA”) with the largest tobacco manufacturing companies in the United States to settle certain claims against manufacturers arising out of the sale, advertising, and consumption of certain tobacco products. (Health & Saf. Code, § 104555, subd. (e).)

Health and Safety Code sections 104555 through 104557 (“Reserve Fund Statute”) impose escrow deposit and reserve fund requirements on tobacco product manufacturers that are not party to the MSA. The reserve fund provides a source of compensation for the financial burdens imposed on the State by cigarette-related illnesses and other health conditions. Existing regulations implement the Reserve Fund Statute.

Revenue and Taxation Code section 30165.1 (“Directory Statute”) requires the Department of Justice (“Department”) to publish and maintain a list of all tobacco product manufacturers and their cigarette and roll-your-own tobacco (“RYO”) brand styles (both cigarettes and RYO are hereafter together “Cigarettes”) that are eligible to be included on the California tobacco directory (“California Tobacco Directory.”) The Directory Statute prohibits California sales of Cigarettes that are not listed on the California Tobacco Directory. In order to have their eligibility for listing on the California Tobacco Directory evaluated, tobacco product manufacturers have been obligated to provide the Department with annual certifications, quarterly reports, and other information regarding compliance with the Directory Statute, the Reserve Fund Statute, and the MSA since approximately 2004.

Sections 999.10 through 999.29 of Title 11, Division 1, Chapter 16 of the California Code of Regulations implement the Directory Statute, the Reserve Fund Statute, and the MSA. Currently, the Department has fourteen forms to implement the Directory Statute, Reserve Fund Statute, and MSA.

The Department proposes to amend, repeal, or consolidate sections 999.10 through 999.29, which implement the Directory Statute, Reserve Fund Statute, and the MSA. The Department also proposes to amend seven of its 14 tobacco forms, which are incorporated in existing regulations, by repealing existing forms and replacing them with newly adopted forms. The regulation and form amendments include: adding definitions for commonly used terms; gather in the information necessary to assess tobacco product manufacturers compliance with the Directory Statute, Reserve Fund Statute, and MSA, updating references to the Board of Equalization to the California Department of Tax and Fee Administration; reducing and eliminating duplicative language appearing in both the regulations and the forms; eliminating outdated or unused processes; and streamlining the process tobacco product manufacturers seek listing on California's Tobacco Directory by replacing hard-copy paper forms with electronic forms, to the extent possible, and requiring attachments to be indexed and organized alphabetically.

III. Anticipated Benefits of the Proposed Regulations

The Directory Statute, the Reserve Fund Statute, and the MSA protect the health and safety of the public by ensuring that tobacco product manufacturers comply with their fiscal obligations to the state associated with cigarette smoking. Existing regulations protect the health and safety of the public and promote fairness by implementing the Directory Statute, the Reserve Fund Statute, and the MSA.

This action to update existing regulations and program forms promote the same public benefits as the existing regulations. In addition, the Department anticipates that this action will streamline the process for a tobacco product manufacturer seeking listing on the California Tobacco Directory, and reduce the workload of the Department and the Tobacco Product Manufacturer.

IV. Specific Purpose and Necessity of Each Section

Section 999.10

Subdivision (a)

Under the Directory Statute and the Reserve Fund Statute, Non-Participating Manufacturers ("NPMs") must deposit tobacco escrow on all of their California Cigarette sales that are Units Sold as defined by the Reserve Fund Statute. Currently, all NPMs deposit escrow quarterly, and document their escrow deposits and California sales of Units Sold on forms JUS-TOB3 and JUS-TOB4. Section 999.10, subdivision (a) was amended to remove reference to depositing escrow less frequently than quarterly and capitalize the words roll-your-own tobacco because it is a defined term.

Subdivision (b)

The Department has added several definitions in subdivision (b) to promote transparency of terms frequently used by both the State and tobacco product manufacturers. For years the California Tobacco Directory has listed Cigarettes by brand style. Directory regulations,

however, do not define “brand style.” Therefore, the regulations are amended to define “brand style” at subdivision (b)(2). It is necessary to define this term as it is used in various tobacco forms.

Subdivision (b) has also been amended to define the terms, “California Tobacco Directory,” Participating Manufacturer,” “Quarter(s),” and “Sales Year” in proposed subdivisions (b)(3), (b)(8), (b)(10), and (b)(14) respectively. It is necessary to define California Tobacco Directory and Participating Manufacturer as those terms are used throughout the regulations and the forms. The definition of Quarter(s) or Quarterly has been moved from section 999.20, subdivision (a) to the definition section for easier reference. “Sales Year” is a term that is used in section 999.14 and various tobacco forms. The definition of “Original Participating Manufacturer” has been deleted as that term will no longer be used in the amended regulations.

Subdivision (b)(1) and other sections have been revised to reflect the change in jurisdiction from the Board of Equalization to the California Department of Tax and Fee Administration (CDTFA). As a result of the Taxpayer Transparency and Fairness Act of 2017, effective July 1, 2017, the CDTFA replaced the BOE in the administration of the Cigarette and Tobacco Products Licensing and Tax Laws. Pursuant to Government Code section 15570.24, any reference to the BOE in statute or regulation is deemed to refer to the CDTFA. Subdivision (b)(1) defining State Board of Equalization was deleted, and the definition for CDTFA was added at subdivision (b)(4). This change necessitated re-numbering of the definitions at subdivision (b).

Subdivision (c)

This action repeals existing subdivision (c). The Department has administered the Tobacco Directory for approximately 17 years. As manufacturers, distributors, retailers, and consumers began to use the Tobacco Directory, the Department initially used subdivision (c) to facilitate exchanges of forms and letters between manufacturers and distributors to identify the brand styles of Cigarettes listed on the Tobacco Directory. Technology, familiarity, and experience with the Tobacco Directory have all significantly improved over the years. Thus, subdivision (c) has been amended to remove the unnecessary requirement that manufacturers submit their JUS-TOB3 and JUS-TOB4 to distributors.

Proposed subdivision (c) confirms that, as in most states, NPMs will continue to deposit tobacco escrow quarterly in California. When depositing escrow, NPMs must still submit a completed JUS-TOB3 and JUS-TOB4 to the Attorney General. The quarterly deposit requirement was moved from existing section 999.20, and amended to apply in all circumstances. The requirement to use JUS TOB-3 when depositing escrow was moved from existing section 999.11.

JUS-TOB3 (Rev. 09/2020)

Form JUS-TOB3 (Rev. 09/2020) was revised to: make it easier to understand and use; help the NPM assess whether a supplemental certification for listing on the California Tobacco Directory is required; and confirm the NPM’s current escrow agent, escrow agreement, and minimum qualified escrow principal on deposit.

JUS-TOB4 (Rev. 09/2020)

Form JUS-TOB4 (Rev. 09/2020) was revised to: make it easier to understand and use; collect data electronically; and require NPMs to identify and document sales in California they contend are not Units Sold. The change will permit the Department to gather material information using a format that reduces the time and expense necessary to complete and review the form for both the Department and tobacco product manufacturers.

Section 999.11

Existing section 999.11 designates the JUS-TOB3 as the form NPMs use to document escrow deposits. Moreover, the regulation duplicates language on the existing JUS-TOB3 form. As addressed above, section 999.10(c) was amended to designate JUS-TOB3 as the form NPMs must use to document escrow deposits. Therefore, section 999.11 will be repealed.

Section 999.14

Section 999.14 governs requests by NPMs to release funds from escrow. Section 999.14 was amended to remove unnecessary and unused sections.

Subdivision (a)

Existing text in subdivision (a) regarding escrow adjustments was amended and moved to subdivision (c) because grouping together the bases for different types of requests, including identifying their supporting documentation, facilitates implementation.

Subdivision (b)

In subdivision (b), the Department confirms that “in a timely manner” means within three years. The definition of “Sales Year” from section 999.10, subdivision (b)(14) will replace the undefined “year of sales.”

Subdivisions (c) and (d)

Section 999.14 addresses two different types of request for escrow releases. Subdivisions (c) and (d) were revised to require that NPMs clearly indicate whether they are making an escrow rate adjustment release request or a Units Sold adjustment release request. The revised text of subdivisions (c) and (d) clarifies the types of documentation NPMs must submit for each type of release request.

The Department has never received an escrow rate adjustment release request. Under existing subdivision (d), NPMs must demonstrate how they calculated their proposed escrow rate. Supporting documentation, however, is both confidential and voluminous. Accordingly, the Department has deleted existing language in subdivision (d) and has amended subdivision (c) to require NPMs to submit their proposed escrow rate and to identify in an affidavit the facts

supporting their contention to initiate a request for an escrow rate adjustment release under section 999.14.

Existing language in subdivision (c)(1) requiring manufacturers seeking a Units Sold adjustment release to submit three different forms has been removed. California's revised JUS-TOB4 (Rev. 09/2020) is a clear and efficient means of gathering information that manufacturers have always been obligated to submit for a Units Sold adjustment release request under Section 999.14. Accordingly, revised subdivision (d)(1) will instruct applicants to use the JUS-TOB4 (Rev. 09/2020) form to improve clarity, expedite reviews, and standardize submissions.

Subdivisions (e) and (f)

Existing subdivisions (e) and (f) have been removed because they are both unnecessary and unused. The Department has determined that preliminary requests are both unnecessary and unreasonably duplicative. CDTFA was never intended to participate in escrow releases and are not required by law to participate. For over 15 years, the Department has not received any requests or other feedback under subdivision (f). Thus, these unnecessary and unused provisions were removed.

Revised section 999.14, subdivision (e) will instruct NPMs where to send their section 999.14 submissions.

Section 999.15

Section 999.15 has been amended to delete a cross-reference to section 999.14(f), which will be removed from the regulation text, as described above.

Section 999.16

Section 999.16 governs the Department's forms for tobacco product manufacturers' annual certifications seeking listing on the California Tobacco Directory. Section 999.16 was revised to identify and implement California's revised forms, which are necessary to assess compliance with the MSA, the Reserve Fund Statute, and the Directory Statute.

Subdivision (a)

Subdivision (a) was amended to make non-substantive changes. Subdivision (a)(1) was amended and renumbered as subdivision (d). Subdivision (a)(2) was renumbered as subdivision (e).

Subdivision (b)

Subdivision (b) amends existing subdivision (b)(1) to recast and list the forms that PMs use seeking listing on the California Tobacco Directory, including the revised JUS-TOB1 (Rev. 09/2020), JUS-TOB8 (Rev. 09/2020), JUS-TOB15 (Rev. 09/2020), and existing forms JUS-TOB 14, 11, 10, and 9. Form revisions are further described below. Subdivision (b)(2) was amended to delete language that was duplicated in the various forms referenced in the regulation.

Subdivision (c)

Existing subdivision (c) was renumbered as subdivision (f).

Proposed subdivision (c) amends existing subdivision (b)(2) to recast and list the forms that NPMs use seeking listing on the California Tobacco Directory, including the revised JUS-TOB5 (Rev. 09/2020), JUS-TOB8 (Rev. 09/2020), JUS-TOB15 (Rev. 09/2020), JUS-TOB7 (Rev. 09/2020), and existing forms JUS-TOB 6, 2, 12, 13, 14, 11, 10, and 9. Form revisions are further described below.

Subdivision (d)

Section 999.16, subdivision (d) was amended because PMs and NPMs will no longer submit the same certification form to be added to the California Tobacco Directory. PMs will submit a JUS-TOB1, and NPMs will submit a JUS-TOB5. Revised Section 999.16, subdivision (d) does not change any due dates or require any additional submissions.

Subdivision (e)

Existing subdivision (a)(2) has been moved to subdivision (e).

Subdivision (f)

Proposed subdivision (f) renumbers and amends existing subdivision (c) to indicate that NPMs shall seek listing on the California Tobacco Directory with a JUS-TOB5 and updates the revision date of the JUS-TOB5 form. Prior references to the JUS-TOB1 form and prior revision dates were removed.

JUS-TOB1 (Rev. 09/2020)

Form JUS-TOB1 (Rev. 09/2020) was revised to modify and add several questions PMs must answer to: establish compliance with the Directory Statute and the MSA; identify the other forms PMs must use during the certification process; remove questions that do not pertain to PMs; improve clarity and ease of use; and ensure that the California Tobacco Directory includes only the tobacco product manufacturers and Cigarette brand styles eligible for listing.

Since the Department last revised its forms, the United States Food and Drug Administration (“FDA”) has declared some tobacco product manufacturers’ Cigarettes to be unlawful for sale anywhere in the United States. Currently, the Department’s forms do not inform tobacco product manufacturers how or when they should relay the FDA’s decisions to the Department. The revised JUS-TOB1 (Rev. 09/2020) provides instructions to tobacco product manufacturers and gathers information to assess compliance.

Form JUS-TOB1 must be signed under penalty of perjury. The necessity for a signature under penalty of perjury is to impress upon applicants the seriousness and importance of signing the

form, to attest to the accuracy and completeness of the information submitted, and to deter misrepresentations and submission of false information.

JUS-TOB5 (Rev. 09/2020)

Form JUS-TOB5 (Rev. 09/2020) was revised to modify and add several questions NPMs must answer to: establish compliance with the Directory Statute and the Reserve Fund Statute; identify the other forms NPMs must use during the certification process; remove questions that do not pertain to NPMs; improve clarity and ease of use; and ensure that the California Tobacco Directory includes only the tobacco product manufacturers and Cigarette brand styles eligible for listing.

Since the Department last revised its forms, the FDA has declared some tobacco product manufacturers' Cigarettes to be unlawful for sale anywhere in the United States. Currently, the Department's forms do not inform tobacco product manufacturers how or when they should relay the FDA's decisions to the Department. The revised JUS-TOB5 provides instructions to tobacco product manufacturers and gathers information to assess compliance.

Form JUS-TOB5 must be signed under penalty of perjury. The necessity for requiring signatures under penalty of perjury is to impress upon applicants the seriousness and importance of signing the form, to attest to the accuracy and completeness of the information submitted, and to deter misrepresentations and submission of false information.

JUS-TOB7 (Rev. 09/2020)

New Form JUS-TOB7 (Rev. 09/2020) requires NPMs to apportion their Cigarette sales by state and indicate the number of Cigarettes upon which they deposited tobacco escrow or tobacco equity fee.

JUS-TOB8 (Rev. 09/2020)

Currently, the definitions used in the Department's tobacco forms are spread over many documents. The revised JUS-TOB8 (Rev. 09/2020) form consolidates the most commonly used definitions in one document to improve clarity and communications with tobacco product manufacturers.

JUS-TOB15 (Rev. 09/2020)

Currently, California uses form JUS-TOB15 (Rev. 09/2020) to gather brand family information, including but not limited to brand style names and UPC codes using paper forms. The Department also gathers additional brand family information throughout the JUS-TOB1 form. The JUS-TOB15 (Rev. 09/2020) form was revised to: gather brand family data in one form; collect data electronically; significantly reduce the information that tobacco product manufacturers must recreate annually; and clearly reflect whether a tobacco product manufacturer seeks to list one of the brand styles they fabricate on the California Tobacco Directory.

Section 999.17

Section 999.17 governs supplemental certifications. Section 999.17 was updated to reflect that PMs shall use the JUS-TOB1 form and NPMs shall use the JUS-TOB5 form when a supplemental certification is required by section 999.17.

Section 999.18

Section 999.18 addresses tobacco product manufacturers' records. Section 999.18 was revised to acknowledge that other laws may govern record retention. The section was also amended to reflect that CDTFA became the California agency responsible for processing tobacco tax returns several years ago.

Section 999.19

Section 999.19 addresses Cigarette distributors' records. The Department has not used the current JUS-TOB5 form for several years. Similarly, as explained above in section 999.10, the Department no longer needs NPMs to send their JUS-TOB3 forms to distributors. Thus, revised section 999.19 removes the requirement that distributors must retain such records.

Section 999.20

As addressed above, revised section 999.10 clarifies that all NPMs must continue to deposit escrow quarterly. Existing section 999.20 governs quarterly deposits and lists specific circumstances when quarterly deposits are required. It is necessary to repeal existing section 999.20 because proposed section 999.10 will govern quarterly deposits.

Section 999.22

The Department notifies California Cigarette distributors of all changes to the California Tobacco Directory. The Department emails notices to all distributors and sends the notices to the impacted tobacco product manufacturers, who send duplicate copies of the notices to their distributors. The distributors then provide the notices to their retailers. For many years, the Department has regularly obtained all of the email addresses of all California licensed Cigarette distributors from CDTFA. Moreover, for many years, the Department's California Tobacco Directory website permits anyone to register electronically to receive all California Tobacco Directory notices by email. Consequently, for over a decade, no California Cigarette distributor has reported any problems with receiving any California Tobacco Directory notices to the Department.

In the past, distributors could fax their email addresses to the Department using the existing JUS-TOB8 form. Given that the Department has not received a JUS-TOB8 in many years, and the other means available for creating and maintaining an email list, the Department and California Cigarette distributors have agreed it is no longer necessary for distributors to fax their email address to the Department.

Therefore, unused and unnecessary text was removed from subdivisions (a) and (b). Furthermore, subdivision (b) revises the references to JUS-TOB1 and JUS-TOB5.

Section 999.23

This section has been amended to delete a reference to section 999.20, which will be repealed.

Section 999.24

Subdivision (a) was revised to reflect that CDTFA became the California agency responsible for processing tobacco tax returns several years ago.

Subdivision (e) revises the reference to JUS-TOB15. Because “roll-your-own tobacco” is within the definition of “Cigarette,” the word cigarette was capitalized as a defined term and the words roll-your-own tobacco were removed as duplicative. Similarly, Tobacco Product Manufacturers was capitalized because it is a defined term.

Section 999.25

There is no substantive change in this section. Section 999.25 was revised to make grammatical changes and capitalize defined terms.

Section 999.26

Section 999.26 was revised to: (1) capitalize defined terms; (2) move one sentence without a substantive change in subdivision (a) to improve clarity; and (3) in subdivisions (b)(8) and (d) to reflect that CDTFA is the California agency responsible for processing tobacco tax returns.

Section 999.29

Section 999.29(a) was updated to reflect that form JUS-TOB15 was revised. As further explained below, tobacco product manufacturers submit hundreds of UPC codes to California on paper forms. The Department has revised the JUS-TOB15 form to receive the information electronically and consolidate the collection of information previously sought in prior versions of form JUS-TOB1.

V. Economic Impact Assessment (EIA)

The Department concludes that the proposed regulations are unlikely to: (1) create or eliminate jobs within the state; (2) create new businesses or eliminate existing businesses within the state; or (3) result in the expansion of businesses currently doing business within the state. This determination is based on the fact that the regulations will not materially impact how approximately 30 tobacco product manufacturers conduct of their business in California.

The Department also concludes that:

- (1) This action protects the health and safety of the public by implementing laws that ensure tobacco product manufacturers make payments to the state to help offset any future legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking.
- (2) This action has no discernable effect on worker safety because it does not regulate workers or working conditions.
- (3) This action may have a slight benefit on the state's environment because the use of electronic forms may reduce paper consumption and waste.

VI. Technical, Theoretical, and/or Empirical Studies, Reports or Documents

None.

VII. Evidence Supporting Determination of No Significant Statewide Adverse Economic Impact Directly Affecting Business

The Department has determined that the proposed regulations will not have a significant, statewide, adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The proposed action will affect approximately 30 tobacco product manufacturers seeking to be added to the California Tobacco Directory. Since approximately 2004, tobacco product manufacturers have been obligated to prepare certifications and other reports to the Department. In order to ensure compliance with the Directory Statute, the Reserve Fund Statute, and the MSA, the Department's forms will be revised to gather relevant information, collect data electronically, and make the forms easier to use and understand. The proposed action will require tobacco product manufacturers to review the new forms and prepare some new responses. The Department anticipates it will cost each the tobacco product manufacturers approximately \$1,000 to implement the changes in 2021. Because many of the tobacco product manufacturers' 2021 revised responses are unlikely to change in subsequent years and the revised forms are much easier to use and understand than the prior versions, the proposed action is unlikely to have a net fiscal impact beyond 2021.

VIII. Reasonable Alternatives to the Proposed Regulatory Action That Would Lessen Any Adverse Impact on Small Business

The Department finds that no reasonable alternatives were presented to, or considered by, the Department that would lessen any adverse impact on small business. Although tobacco product manufacturers may incur additional minimal costs when initially completing the updated forms, the Department anticipates that this action will result in a less burdensome, streamlined application process.

IX. Reasonable Alternatives to the Proposed Action and the Agency's Reason for Rejecting Those Alternatives

The Department finds that no alternatives were presented to, or considered by, the Department that would be more effective in carrying out the purpose of the proposed regulation or would be as effective and less burdensome to affected private persons than the proposed regulation.

The proposed action is the most effective way to ensure compliance with the Directory Statute, the Reserve Fund Statute, and the MSA. Although tobacco manufacturers may incur additional minimal costs when initially completing the updated forms, the Department anticipates that this action will result in a less burdensome, streamlined application process. Not taking any action will keep in place a more cumbersome application process.

Performance Standard as Alternative:

The Department makes every effort to consider performance standards when possible. This action prescribes mandatory forms to ensure uniform compliance by tobacco product manufacturers with the Directory Statute, the Reserve Fund Statute, and the MSA.